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Summary record of the joint meeting of the Second Committee and the Economic and Social Council on lessons learned from the debt crises and the ongoing work on sovereign debt restructuring and debt resolution mechanisms

Held at Headquarters, New York, on Tuesday, 14 October 2014, at 3 p.m.

Co-Chair: Mr. Cardi (Chair, Second Committee) ..... (Italy)
Co-Chair: Mr. Sajdik (President, Economic and Social Council) ..... (Austria)

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The meeting was called to order at 3.10 p.m.

Introductory remarks

1. **Mr. Cardi** (Co-Chair) said that the current joint meeting of the Second Committee and the Economic and Social Council, with its broad agenda, offered a unique opportunity to enrich the debate on sustainable development in all its dimensions and to make a final push towards meeting the Millennium Development Goals, while making a significant contribution to the formulation of the new development agenda.

2. The issue of sovereign debt crisis prevention and management had taken on a new urgency in the wake of the recent global financial crisis. Excessive sovereign debt was a global phenomenon which affected international economic, political and financial stability. International forums such as the International Monetary Fund, the United Nations Conference on Trade and Development, the United Nations, the Commonwealth Secretariat, and non-governmental organizations and academic circles had organized meetings and conducted research on potential debt workout mechanisms, with a view to addressing ongoing concerns about the management of debt restructuring. Various General Assembly resolutions had called for stronger efforts to prevent debt crises, highlighting the need for improved efficiencies and coordination in debt restructuring at the international level.

3. Many valuable lessons could be learned from the debt crises, including the fact that discussions at the international level would be instrumental in dealing effectively with sovereign debt crises, defaults and disputes in the future. Inclusive, transparent and factual discussions among all stakeholders were therefore paramount for devising an effective solution to those problems and fostering economic growth and development.

4. **Mr. Sajdik** (Co-Chair) said that General Assembly resolution 68/202 had called for consideration of enhanced approaches to sovereign debt restructuring and encouraged relevant organizations within the United Nations system to continue discussions on the need for and feasibility of a more structured framework for international cooperation in that area. The current meeting was an important step in that process. It was widely acknowledged that addressing debt problems would be an important component of the financing framework for the post-2015 development agenda. However, sovereign debt crises were a global phenomenon which was not confined to emerging markets or low-income economies, as many developed countries were also struggling with heavy public debt burdens. Such crises could also threaten international financial stability because debt problems in one country could spread to others.

5. There had been progress in the debt sustainability indicators of low-income countries as a result of the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative, with many of them issuing bonds on international markets. However, such aggregate indicators masked sustainability problems in individual countries, with new debt issuance raising new sustainability concerns in some of those countries. In addition, some countries, including small States with debt problems, had not been covered by those initiatives. Moreover, the slowdown of the global economy and reduced monetary easing in the United States had added to concerns about the resilience of other emerging markets and developing countries. Responsible debt management policies should therefore be promoted to ensure fair burden-sharing and inter-creditor equity, while at the same time strengthening fiscal consolidation to avoid high government debt-to-gross domestic product ratios, which had a deleterious effect on long-term growth.

6. While there was general agreement as to the need for enhanced approaches to sovereign debt restructuring, there was no consensus among analysts on the way forward. Some believed that improved language in bond contracts and a voluntary code of conduct would address problems related to holdout creditors and other issues, while others felt that they would be insufficient. There were therefore calls for further policy action on debt restructuring and sovereign debt resolution. He hoped that the current meeting would contribute to a better understanding of the policy options that would help to build momentum in order to find solutions for countries that faced such problems.

Panel discussion on lessons learned from policy responses to contagion and debt crises and implications of the changing landscape for debt restructuring

7. **Mr. Kozul-Wright** (United Nations Conference on Trade and Development), moderator, said that the United Nations Conference on Trade and Development (UNCTAD) had a long history of carrying out analyses

and providing policy recommendations in the areas of trade and development, finance, investment and sustainable development. Specifically, as the focal point of the United Nations system on debt issues, it had focused its work in that area on risks to developing countries as a result of global imbalances, and on the need for a robust debt resolution mechanism. Sudden shocks caused by natural disasters, rapid changes in exchange rates or abrupt movements in interest rates had caused many fiscal and debt sustainability problems in developing countries. Moreover, as the Asian and subprime and European crises had demonstrated, contagion posed real challenges in the current interconnected global environment.

8. Public debt in most developing countries and transition economies had undergone structural changes in the past decade. Locally and internationally issued securities continued to account for the bulk of public debt in transitioning and developing countries, whereas bank loans and bilateral debt made up a small proportion of that debt. That had opened new opportunities but also left developing countries vulnerable in times of debt distress because mechanisms for restructuring bonds were slow, leading to costly defaults. Policymakers in developing countries should not forget that private sector debt could quickly become public debt, causing adjustment and policy problems and, ultimately, economic and human distress.

9. In that connection, the process of creating a more equitable environment for debt restructuring required international coordination and collective, inclusive and transparent ex ante dialogue, which would help to determine the legal, political and institutional outcomes of the design of a debt restructuring mechanism and ensure its future effectiveness.

10. **Mr. de Lecea** (Delegation of the European Union to the United States) said that the Monterrey Consensus of the International Conference on Financing for Development had identified sustainable debt financing as an important element for mobilizing resources for public and private investment. Sound macroeconomic policies had strengthened economic fundamentals in most developing countries and emerging markets and made their debt levels more sustainable. As a result, many of those countries had been able to access global markets and benefit from international capital flows. In some of those countries, however, debt had become unsustainable, making restructuring inevitable.

11. The restructuring process followed two patterns for two different groups of countries: those with few, mainly public creditors; and those with access to global capital markets, and hence mainly private creditors. For several low-income, over-indebted countries with financing under the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative, debt write-offs had given them the fiscal space needed for investment and growth and even allowed some of them to tap international financial markets for the first time ever. According to the International Monetary Fund, aggregate debt write-offs by bilateral and multilateral creditors under both initiatives had reached more than $110 billion in net present value terms. Such developments showed that multilateral cooperation had been effective in the area of State-to-State debt resolution.

12. In the case of countries that raised funds on bond markets, the challenge had been to involve numerous creditors in a market-based negotiation and restructuring process, leading to concerns that coordination among numerous bond holders could endanger the whole debt restructuring process. Those concerns were illustrated by a number of court cases, which also pointed to potential weaknesses in the current framework. The International Monetary Fund had steered a review of sovereign debt restructuring at the global level in an effort to address some of those weaknesses. In that connection, the Fund had recommended the removal of *pari passu* clauses from sovereign bond contracts in order to preclude legal uncertainty in the interpretation of those contracts.

13. The experience of the European Union with sovereign debt problems had shown that the high degree of economic and financial integration among the member States of the Union posed new challenges, which were compounded by the increased complexity of the global financial system. Those challenges had coalesced into a "perfect storm" in 2009-2012, prompting crisis management and institutional reform and forcing the European Union to repair its ship in the middle of that storm. Before the financial crisis, an overreliance on credit rating agencies, which determined the ability of institutional investors to buy and hold sovereign bonds, created dangerous cliff effects which led to further financial vulnerability. As a result, a wide range of regulatory measures and actions

had been taken by global institutions, including the European Union, to reduce the reliance on credit rating agencies.

14. The experience of the European Union had also shown that aggregation provisions in bond contracts were needed to enable most bond holders to change the terms of bonds where necessary. Since 2013, all euro zone sovereign bonds issued with a maturity of more than one year must contain collective action clauses with strengthened aggregation provisions to facilitate debtor-creditor discussions. In the case of the Greek debt restructuring crisis, the exercise was relatively easy from a technical point of view because it concerned mostly debt issued under domestic law. Nonetheless, it also came with substantial financial stability risks and had to be performed as part of a comprehensive crisis management approach that included substantial macroeconomic adjustment and efforts to prevent the crisis from having a contagion effect on other countries. The European experience had indeed shown that prevention was better than cure.

15. Lastly, turning to the lessons learned from recent developments and crises, he noted that sound macroeconomic policies and governance had increased the capacity of many countries to borrow from public and private sources; legal feasibility was not the only criterion to be taken into account before triggering debt restructuring since financial stability risks as unintended consequences of restructuring must also be considered; and sovereign debt restructuring was an extreme solution to be resorted to only in extreme circumstances. Building on those lessons would restore the role of debt financing in mobilizing resources for public and private investment and thus foster growth and development.

16. **Mr. Batista** (International Monetary Fund), speaking in his personal capacity and not on behalf of the International Monetary Fund, said that the Fund had faced risks arising from the case involving Argentina and holdout bondholders or vulture funds in the United States, and had been following developments relating to that case closely, if rather helplessly. In 2013, it had been ready to present an amicus curiae brief to the United States Supreme Court urging it to consider the consequences of the rulings of the New York courts in the case, but intervention by the United States Treasury had led the Fund to desist from that initiative. Three other countries had presented their own amicus curiae briefs to that Court, but the Court had refused to consider the Argentine case and the decisions of the lower instances had prevailed. If, because of litigation by a minority of holdouts or vulture funds, Argentina had been rendered unable to pay the debt that had already been restructured, then a default would have occurred as a result of the intervention of the judicial system of a single country.

17. In 2014, however, the International Monetary Fund had made some progress in dealing with the actual and potential consequences of that situation by participating in an initiative of the United States Treasury that had led to the endorsement by the Executive Board of the Fund of changes to contractual provisions of international sovereign debt issuances, namely, reform of the *pari passu* clause to make it explicit that the interpretation made by the New York courts in the Argentine case was not acceptable; and an enhancement of the collective action clauses to enable an aggregation of those clauses across a series of bond issuances. It was worth noting that even prior to the decision by the Board, a number of countries had already incorporated either or both of those changes into their bond issuances. For example, Ecuador and the Dominican Republic had already incorporated the *pari passu* and collective action clauses, respectively, into their bond issuances. Since the decision of the Board, Kazakhstan had incorporated both of those provisions into its latest bond issuance, which ended up being oversubscribed.

18. Nonetheless, further reform would be needed, in part because many countries still had a large stock of existing bonds featuring the older, weaker collective action clauses or no such clauses at all. Those countries therefore remained vulnerable to copycat litigation by speculative investors in the event of restructuring. Grenada, for example, had already been suffering from one holdout creditor whose legal strategy was inspired by the Argentine litigation. Were Grenada to succeed, it would have to do so in the shadow of the increased leverage of speculative investors in light of the Argentine decision. It was not sufficiently clear whether the Argentine case represented a solid precedent or whether it was so unique that it could not be used easily by vulture funds against other countries. It did appear, however, that the Argentine case was unusual not only because the investors had pursued aggressive litigation, but also because Argentina itself was holding out against them. Nonetheless, the jury

was still out as to the real implications of the court's decision in that case.

19. The United Nations had a role to play in the matter because it was a forum where all countries had a greater voice. General Assembly resolution 68/202, on a sovereign debt resolution mechanism, had been adopted with a majority vote of about 64 per cent, with only 6 per cent of Member States voting against. The 6 per cent of countries that voted against the resolution held almost 40 per cent of the voting power in the International Monetary Fund, while the 64 per cent that voted in favour held 35 per cent of the voting power in the Fund. Hence, that resolution would have been defeated in the Fund owing to the unequal distribution of voting power in that institution. He was not calling for one-country-one-vote system in the International Monetary Fund, but the United Nations had a balancing political role to play in the discussions on addressing the existing stock of debt, and on dealing with the "too little, too late" syndrome in debt restructuring. That syndrome had led to the socialization of losses in debt relief since the private sector often managed to shift the burden of losses to the public sector. The proposed changes to the contractual framework did not address those problems.

20. **Professor Gelpern** (Georgetown University) said that sovereign debt was a bizarre puzzle: unlike other types of debt, it was not directly enforceable, but it also never went away; a sovereign debtor's assets could not be confiscated, nor could Governments go bankrupt and start afresh. Despite that peculiarity, sovereign debt was the lifeblood of the global financial system. Indeed, sovereign bonds worth at least $40 trillion constituted base assets in banking systems and in reserves as collateral in capital markets around the world. Sovereign debt was difficult to gauge because of the contingent liabilities Governments took on by backing sub-sovereign entities, their own banking systems and other socially important parts of their economies. Sovereign debt crises were also always preceded or followed by a financial, banking or other type of crisis, such that their importance was magnified on every occasion.

21. The International Monetary Fund had reported that more than $900 billion of the $40 trillion in bonds worldwide were in foreign-law bonds, over half of which were issued by emerging market Governments. Such bonds were problematic because they deprived Governments of certain debt management tools, particularly in times of distress, and also gave creditors a false sense of security; they were not easy to enforce, yet created the expectation that there was a reliable source of repayment. In the recent case of Argentina, creditors had attempted and ultimately failed to enforce their contracts by forcing the country to pay. However, they ended up causing damage to third parties in the global financial system. Such action amounted to attempted enforcement by spillovers. The result was that the unpaid sums had risen from $12-20 billion to $40-50 billion, with more uncertainty going forward.

22. There were two interconnected sets of problems with sovereign debt, namely, ex ante or debt management problems, and ex post or debt restructuring problems. Concerning the former, determining how much a country borrowed was just as crucial as determining whether the sums would be used for productive or legitimate purposes. The restructuring process could also affect the country's future borrowing capacity. For that reason, the UNCTAD principles on responsible lending and borrowing were important not just for debt management in the future but also as a prism through which debt restructuring should be considered.

23. There were three sets of problems with debt restructuring, namely, efficiency, fairness and legitimacy. Efficiency related to the sustainability of the debt profile and the timing of restructuring, with many countries failing to restructure soon enough. There were also process issues, with disruptions from holdout creditors. Unfair outcomes resulted from fragmentation of the debt restructuring process as various categories of debt and different groups of creditors were restructured in different places, under different rules and at different times.

24. The problem of process fairness was highlighted in cases where dispersed groups of creditors with no direct relationship with one another were restructured without the supervision of a single forum, thus creating the potential for free-riding and unfair burden-sharing, with some creditors and stakeholders subsidizing others. The problem of legitimacy could be embodied in the legitimacy of outcomes, where the outcome of the restructuring might not be accepted by its constituents. A direct corollary of the issue of legitimacy was one of intelligibility. Contrary to allegations, debt restructuring was not ad hoc and was usually highly predictable and remarkably regular for such a decentralized process. However, only those who

were intimately involved with the process knew how it would play out most of the time. The process was unintelligible to its main constituents, namely the people, and also to ordinary creditors. When the process was not well understood, it was perceived as illegitimate.

25. Progress had been made toward solving some of those problems, in spite of political and technical challenges. The emerging sovereign debt restructuring framework was a multi-part modular system which was not based on either contracts or statutes. Contractual reforms were important for dealing with process disruption and free-riding, but they were by definition decentralized and did not, therefore, address the issue of fragmentation. The International Monetary Fund should be commended for its policy reforms, which included contract recommendations, and for efforts to reform its own lending policies and debt sustainability analyses, which would help with efficiencies and burden-sharing. However, that did not constitute a comprehensive system.

26. In the future, it would be necessary to move away from choices between contracts and statutes; the overall framework should be borne in mind and it would be interesting to see how many modules could be devised and made coherent such that they could be accepted by the constituents of debt restructuring.

27. **Ms. Frankinet** (Belgium) said that Mr. Batista had emphasized the importance of the United Nations as a forum where a political balance could be struck. It would be interesting to know what topics or areas on which the United Nations should focus, as a complement to the activities of the International Monetary Fund and other bodies with regard to the restructuring of sovereign debt.

28. **Mr. Batista** (International Monetary Fund) said that the factor common to all debt restructuring problems was the difficulty faced by the official sector, both national and multilateral, in dealing with the overwhelming power of private finance and its capacity to cause instability and even destruction. The United Nations should therefore direct its efforts toward correcting the imbalance between the influence of massive capital movements and the financial sector over the official sector. That was important because the cost of that imbalance was often borne by ordinary citizens of both the debtor and the creditor countries. Restructuring that was "too little, too late" enabled private sector finance to shift claims on problematic debtors to the official sector.

29. The International Monetary Fund would continue to address issues such as the existing stock of debt and the timing of debt restructuring. If it did not happen soon enough, official money provided by the Fund or creditor countries would be used to pay private sector creditors at par, thus allowing them to exit unsustainable debt situations, as in the case of Greece, where there had been a major socialization of losses. The United Nations was not a technical body and should rely on the work performed by bodies such as the International Monetary Fund. It did, however, have an important political role in overseeing that work and ensuring that it was done in a balanced manner for the benefit of the international community as a whole.

30. **Mr. Usui** (Japan) said that it was important to solve the debt problem for the sake of sustainable development, because excessive debt created difficult conditions for developing countries. Japan had been tackling the issue through debt relief and debt reduction and by contributing to discussions on remedies at the International Monetary Fund, the Paris Club, the United Nations Conference on Trade and Development and other forums. Japan had established a debt relief scheme since 1978 and in the last decade it had cancelled 2.2 trillion yen of debt owed by developing countries, mainly in sub-Saharan Africa. Japan had also made it a priority to build the capacity of those countries to manage their debt and introduce macroeconomic policies that would keep them on the right track after debt relief. Japan had been a major player in alleviating the burden of indebted countries through the Paris Club.

31. It would be difficult for Japan to support the establishment of a multilateral debt restructuring mechanism through the United Nations, which would be unworkable especially if it was created hastily, and was not realistic in the near future. Fortunately, other forums existed, such as the International Monetary Fund, where good progress had been made in the area of debt restructuring.

32. **Mr. Normand** (France) said that more information on the significance of the strengthened collective action clauses advocated by the International Monetary Fund would be welcome.

33. **Mr. Batista** (International Monetary Fund) said that traditional collective action clauses required a

super-majority of creditors, typically 75 per cent, but in the event of restructuring, votes were taken on a series-by-series basis, meaning that each bond affected by the restructuring was voted on separately. As a result, speculative investors had been able to buy blocking minorities in specific series and upset the whole process. The solution endorsed by the Board of the International Monetary Fund was therefore to aggregate all the series of the eligible debt for restructuring and to have the option of a single vote among all participating creditors with a super majority of 75 per cent, for example, to be determined on a case-by-case basis as the new bonds were issued. That made it more difficult for speculative investors seeking to pursue litigation to buy a blocking minority in the debt of any given country, provided that country issued bonds that contained collective action clauses.

34. **Mr. de Lecea** (Delegation of the European Union to the United States) said that, in the case of Greece, there had been 17 bond series with a total face value of 6.5 billion euros, but a minority of bondholders had rejected the restructuring. As a result, Greece had had to pay in full in order to avoid a default.

35. **Mr. Alemu** (Ethiopia) said that the most important forum for discussing the issue of debt restructuring in the context of the United Nations was the upcoming International Conference on Financing for Development. Suggestions from the panellists as to what the aims of the Conference should be and what outcomes could reasonably be expected would be welcome.

36. **Professor Gelpern** (Georgetown University) said that the most important thing the United Nations could do was to use its agenda-setting power to keep debt restructuring issues at the forefront of negotiations in other forums. Information on restructuring experiences should also be made publicly accessible and intelligible, possibly through a United Nations information repository.

37. **Mr. Batista** (International Monetary Fund) said that the United Nations could use its many forums, including UNCTAD and other bodies such as the International Monetary Fund, to discuss ways of moving forward on the topic of debt restructuring. It should bear in mind, however, that the International Monetary Fund was a technical body that could provide input, but not necessarily guidance, as its governance and political imbalances made it incapable of adopting a truly multilateral stance.

38. **Mr. Kozul-Wright** (United Nations Conference on Trade and Development), moderator, said that it should also be borne in mind that the International Monetary Fund was also a creditor, a status which could affect its engagement in such an exercise, particularly given the creditor bias built into the current system.

39. **Ms. Vu** Minh Thuy (Viet Nam) said that Professor Gelpern had referred to the unintelligibility of the debt restructuring process, saying that those who were intimately involved in the restructuring process knew how it would play out most of the time. It would be interesting to know who those people were and whether they were politically connected or simply had more experience.

40. **Professor Gelpern** (Georgetown University) said that she had not intended to suggest that there was a conspiracy of the politically connected. Rather, only a handful of law firms had carried out the bulk of debt restructuring and only about ten persons at those firms had the necessary knowledge and experience. The Paris Club had become more transparent but that was a recent development. Unlike the proceedings of a bankruptcy court, restructuring was a decentralized process that empowered repeat players and the small number of people who had the requisite expertise.

41. **Mr. Samudera** (Indonesia) asked what legal obstacles the multilateral mechanism might face, and whether a combination of the contract- and statute-based approaches to debt restructuring could be envisaged.

42. **Professor Gelpern** (Georgetown University) said that legal impediments to a multilateral framework were dependent on the nature of the framework, which should not be prejudged. If the framework consisted of multiple but coherent solutions in multiple forums, there would be no legal impediment. For example, following the defeat of the sovereign debt restructuring mechanism at the International Monetary Fund, the Security Council had immunized Iraqi oil and gas proceeds, thereby protecting a debtor more securely than any normal debtor would be in a bankruptcy. The United Nations therefore had both a legal and a political capacity to guide the agenda.

43. Referring to the second question, her point had been that as long as discussions centred on an opposition between statute- and contract-based approaches to debt restructuring, no multilateral framework could be achieved. The ideal solution was a modular approach. Changes to collective action clauses and the *pari passu* clause were only one set of solutions to a discrete set of problems; they did not even solve all the free-riding problems, for example. The United Nations therefore had a role in keeping track of the overall agenda, identifying problems and solutions, and ensuring that the modular solutions were part of a comprehensive vision.

Panel discussion on ongoing work on sovereign debt restructuring and debt resolution mechanisms

44. **Mr. Trepelkov** (Department of Economic and Social Affairs), moderator, said that the prevention and management of sovereign debt crises had taken on a new urgency since the global economic and financial crisis. External debt problems were no longer confined to developing countries, and debt crises in systemically important countries threatened global financial stability. Following calls for an improved debt restructuring framework since the Monterrey Conference on Financing for Development, the General Assembly had adopted resolution 68/304, entitled "Towards a multilateral legal framework for sovereign debt restructuring processes".

45. However, debt restructuring was a complicated task that could only be achieved by aligning debtor and creditor interests and incentives; preventing holdouts; addressing the "too little, too late" problem; ensuring a speedier return to growth for debtors; providing for legal predictability and fair burden-sharing between debtors and creditors; and ensuring smooth functioning of debt markets and maintaining global stability. During the current panel discussion, participants would exchange ideas on ongoing efforts to improve debt crisis prevention and management, and identify areas where further work was needed to build a resilient financial architecture for sovereign debt restructuring.

46. **Mr. Baqir** (International Monetary Fund) said that the most recent phase of work on sovereign debt restructuring at the International Monetary Fund included a review of the idea of strengthening contractual provisions in international sovereign bonds by reforming the *pari passu* and collective action clauses, which had already been addressed by Mr. Batista. There was a concern that even if the international community endorsed the use of new contractual provisions in issuances going forward, that would not solve the problem of the existing stock of bonds with the old contractual provisions. In that connection, the Fund would be monitoring the pace of adoption of those new provisions and would use various forums, such as the meeting held regularly with public debt managers from around the world, to promote their use.

47. The Fund was also working on the relationship between sovereign debt restructuring and the Fund's lending framework. In a situation of sovereign debt distress, the Fund's lending decision often determined whether a country's debt was restructured and the extent of such restructuring. The implication was that the lending policies of the lender of last resort in the global financial architecture were keys to the decision of a country to restructure its sovereign debt. Yet, the Fund had not changed its lending framework for large-scale financing, known as the exceptional access framework, which it had set up in 2002 when shareholders had become concerned that lending to countries with doubtful debt situations was not helping to resolve the underlying problems, as those countries often deployed official resources to pay off private creditors.

48. At that time, the Fund had adopted criteria that enabled lending at exceptional access levels, namely in very large amounts, only if a country's debt was assessed to be sustainable with a high probability, which meant a higher bar for the assessment of sustainability than for normal lending conditions. If that threshold was not met, the Fund had to ask for upfront debt reduction that would be sufficient to make the country's debt more sustainable with high probability. However, that underlying feature of the 2002 framework mandated action on debt that might be too drastic in cases where the debt sustainability outlook was not clear-cut. In such cases, it made sense to bite the bullet and embark on debt reduction if it was evident at the outset that adjustment alone could not solve the problem. It was, however, questionable whether it was warranted to require upfront debt reduction when the debt prospects were uncertain, putting undue pressure not only on the debtor country but on the creditors as well.

49. In such situations of uncertainty, it would be more efficient to ask creditors to maintain their

exposure rather than inflict the costs of debt reduction upfront. Creditors would be asked to accept a limited extension of maturities with no cut in face value and generally no reduction in coupon, to give the programme time to succeed. The process would be voluntary and market-based, and creditor consultation would be key, with the Fund providing information and analysis. That limited extension of maturities, also known as the reprofiling option, had been used successfully in normal access programmes, most prominently in the case of Uruguay in 2003. The exceptional access framework would thus become more flexible and better calibrated to the spectrum of debt problems that countries faced. As long as the reprofiling was used to support a credible adjustment programme, it would be less destructive to countries' financial systems and have a reduced contagion effect on foreign financial markets. Experience had shown that the impact of restructuring on the financial sector depended on whether it was a deep restructuring inflicted on creditors or a light restructuring in the form of reprofiling in which certain maturities were extended by a few years.

50. In 2010, the Fund had faced the prospect of asking for an upfront debt reduction as a condition for large-scale support to Greece since its prospects for debt sustainability had been uncertain. That had raised concerns about possible contagion to other euro zone countries, and as a result an exemption, known as the systemic exemption, had been created to allow lending without debt restructuring even where there was uncertainty over debt sustainability and a high risk of international systemic spillovers. That exemption had subsequently been invoked not only for Greece but also for Ireland and Portugal. It had served as a quick fix to deal with rigidities in the lending framework, but it was not a long-term solution, since it had revived concerns which the 2002 reform had been meant to address, including moral hazard concerns; it had also raised fresh concerns about even-handedness; and it was not clear whether it even achieved its original objective of mitigating contagion.

51. In Europe, the use of systemic exemptions did not help debtor countries but it did help foreign creditors. Speculation had persisted and only after decisive action had been taken in 2012 to bolster the firewalls of the European Stability Mechanism and the European Central Bank and to restructure debt had contagion finally subsided. More effective approaches to contagion risks were therefore needed and in most cases where reprofiling was called for, countries should manage those risks using the measures routinely deployed by central banks to deal with market volatility, with back- up financing provided by the Fund when needed.

52. The Fund indeed had extensive experience in helping countries with restructuring and its staff had developed contingency measures with the help of central banks to avoid untoward consequences of such restructuring. However, in the future, the systemic threat could be perceived as being so great that any kind of debt operation, including reprofiling, was considered too risky by the Fund's membership, in which case an alternative would be to combine Fund financing with other official resources on concessional terms to render the distressed country's debt situation sustainable with high probability. That would be a more effective antidote to contagion since it would avoid debt restructuring while credibly addressing countries' debt problems.

53. In conclusion, there was a strong case for a reform that would make the Fund's lending framework more flexible by reintroducing the reprofiling option; it would provide for debt restructuring options that were more proportional to the degree of stress in debtor countries; and once the underlying framework had been made more flexible, the systemic exemption could be eliminated and more effective approaches for dealing with contagion risks could be implemented. The Fund would also be working on policies for receiving financing assurances and for dealing with arrears concerning official creditors, and on the process to be followed between a creditor and a debtor in situations where the debtor had already defaulted.

54. **Ms. Yuefen** Li (United Nations Conference on Trade and Development) said that, at a time when more developing countries, including least developed countries, were entering the bond market and the litigation of the century against Argentina was still not resolved, the interest in the development of a debt workout mechanism was understandable. Attempts by the International Monetary Fund to strengthen the collective action clauses and *pari passu* language in contracts were welcome and should not be considered mutually exclusive. It should be borne in mind that the international community aspired to an orderly, timely, efficient and fair debt restructuring mechanism. While the proposals by the Fund would be instrumental in

that regard, there were still several gaps and systemic issues to be addressed.

55. Much of the outstanding sovereign debt contracts in the world did not have the strengthened collective action or *pari passu* clauses and it would take years for those strengthened clauses to be incorporated into new bond contracts. In the meantime, some of the heavily indebted poor countries entering the bond market might still be vulnerable to attacks by vulture funds, which considered those countries easy prey since they had benefited from debt relief which had provide them with the sums to pay the vulture funds, and did not have sufficient resources to defend themselves legally.

56. Furthermore, regardless of how bond series were aggregated, in the case of smaller and poorer countries with few bonds, a single hedge fund could buy 75 or 80 per cent of the bonds; creditor coordination was therefore still a problem. Retroactive action was also not easy because revised clauses could lead to a credit event. The strengthened *pari passu* clause was a step in the right direction but it was only one of the boilerplate clauses in debt contracts. There was no guarantee that, in the future, confidentiality, force majeure or warranty clauses would not be given innovative or extraordinary interpretations by certain judges. Nonetheless, many of the systemic problems that remained, including the fragmentation of legal forums, the differing decisions that could be rendered on the same issue by different courts, the uneven abilities of judges to understand the intricacies of bond contracts, and the "too little, too late" approach, could not be addressed by strengthening certain clauses.

57. As the focal point of the United Nations on debt issues, UNCTAD had a track record of analytical work on debt workout, which had intensified with the onset of the global financial crisis. Since the adoption of the General Assembly resolution on debt restructuring, UNCTAD had focused its work on debt crisis prevention and crisis resolution. With financing from the Government of Norway, it had set up a project on the promotion of responsible sovereign lending and borrowing, and a working group that brought together multilateral financial institutions, including the International Monetary Fund, the Paris Club, the World Bank Group and development banks, as well as non-governmental organizations, academia and the private sector. The working group had formulated a set of principles focusing on debt crisis prevention, some of which dealt with debt workout mechanisms. The process had been inclusive and transparent and 13 countries had already endorsed it.

58. In 2013, UNCTAD had devoted its efforts on the development of a debt workout mechanism, after having organized a high-level meeting on the topic in 2011 which had triggered a discussion in the international community following the global financial crisis. A debt workout mechanism was a cross-cutting issue with legal, economic, political and social strands. In that connection, UNCTAD had once again set up an inclusive working group involving a wide variety of actors, which had identified the main problems facing debt restructuring mechanisms, mainly creditor coordination, the variety of legal forums, fragmentation, procrastination and efficiency. It had identified a number of principles which could guide better debt restructuring, including the principles of legitimacy, impartiality, transparency, good faith, and debt sustainability. Its experts had prepared background papers for each principle and refined them in the light of discussions in the working group. The group had then prepared the processes of debt restructuring, identifying five types of debts and five groups of creditors, and taking into account the problems with the current debt restructuring mechanisms. The draft would be completed and submitted soon.

59. In conclusion, there was a great deal of interest in the introduction of a debt workout mechanism, even a hybrid one. It was important for developed and developing countries to complement each other in that effort. UNCTAD would work with all stakeholders to establish an orderly debt restructuring mechanism that would benefit both creditors and debtors and the international community as a whole.

60. **Ms. Schneider** (Department of Economic and Social Affairs), accompanying her statement with a digital slide presentation, said that she had been working on a project intended to foster mutual understanding among stakeholders, namely Governments, international organizations, the private sector and civil society, in identifying areas where sovereign debt restructuring required policy action. Considerable progress had been made in that effort, because the private sector had initially denied that there were any problems, but had now come to a better understanding of the problems surrounding debt restructuring. The strategy adopted had been to deconstruct the sovereign debt restructuring

mechanism and to allow participants to propose options for each of those issues and to determine whether they could be addressed through a market-based approach or a statutory approach.

61. The sovereign debt restructuring system was fragmented: there was debt to multilaterals, debt to official creditors, debt to commercial creditors and bond debt. Moreover, multilateral debt could not be restructured, although an exception had been made for heavily indebted poor countries covered by the Multilateral Debt Relief Initiative. The International Monetary Fund did not have the wherewithal to call for sovereign debt restructuring. At best, it could play an advisory role or influence the incentive structure for sovereign debt restructuring through its lending-into-arrears policy.

62. As for negotiations under the Paris Club, they covered only members of the Club, yet in recent years non-Paris Club bilateral debt had become very important in official-sector lending. Furthermore, Paris Club agreements required comparable treatment for other creditors and many countries that had benefited from the Heavily Indebted Poor Countries Initiative had been the target of litigation by vulture funds because they did not receive comparable treatment. A related topic was that of debt to commercial banks, which was covered by an informal gathering known as the London Club, which lacked an oversight body and was not efficient for commercial bank restructuring.

63. As for bond debt, the International Monetary Fund proposals for the amendment of bond contracts and contractual technology to prevent holdouts and for a narrow interpretation of the *pari passu* clause to allow for equal ranking but not rateable payments among creditors would minimize holdouts but would not eliminate them altogether. Indeed, in the case of small economies with a few bond issues in small amounts, it was easy for vulture funds to hold out and delay debt restructuring.

64. On the issue of litigation, the hand of holdout creditors had been strengthened by the amendments to sovereign immunities legislation in the United States, the United Kingdom and other countries to exclude commercial activities from sovereign immunity; a court judgement which had declared that sovereign debt was a commercial activity and therefore excluded from sovereign immunity; and the jeopardy rule which precluded the purchase of debt at a discount in order to use it for litigation.

65. It was widely accepted that the Argentine litigation was a game changer that would affect future debt restructuring by strengthening the position of holdout creditors, and that illustrated the legal gaps in the debt restructuring architecture. There was a great deal of diversity in the types of restructurings offered. Debt restructurings with few or no nominal haircuts tended to move very quickly, but then required multiple restructurings, which had an impact on growth and debt sustainability in the long run and did not change the volume of debt. For deeper haircuts, often requiring creditor cajoling, negotiations were often protracted, leading to uncertainty.

66. There was evidence that default and restructuring appeared to be negative for debt and positive for growth, meaning that when a country defaulted, as in the case of Argentina, it grew very rapidly after the default and debt burdens went down. There was also evidence that there was a strong reduction in growth before a default. There was therefore a need to find policies that prevented a fall in growth before that default. Hence, the costs of restructuring were very high in terms of output, trade losses, and access to credit, higher spreads, and the like.

67. One of the achievements of the expert group meetings organized by the Department of Economic and Social Affairs on debt restructuring was that they had led to a greater understanding of the issues involved between the private sector and the official sector. Previously, the private sector had measured the success of a debt restructuring scheme by the percentage of bond holders who participated in the scheme and how quickly it was completed, and how well the instruments performed after the debt restructuring, whereas the official sector was more concerned with the cost to the local economy, the residual debt burden, and the speed at which the country could return to a sustainable debt and growth trajectory.

68. Furthermore, for the private sector, the problem of procrastination related to the time needed to reach a settlement, whereas for the official sector, procrastination related not only to the delay before debt restructuring was initiated but also to the time it took to reach a settlement. Delays were also disastrous because they gave vulture funds more time to purchase

debt at a discount then hold out for high gains. The next expert group meeting would look at the lending-into-arrears policy and the related amendment being considered by the International Monetary Fund. The good faith criterion that was added to that policy gave an advantage to lobbying by the private sector, but the creditors too should be required to meet the same good faith criterion.

69. A number of options were being considered for sovereign debt restructuring in the future, including the upgrading of contractual technology in order to improve the voluntary market-based approach; a statutory solution to address holdouts by minimizing litigation risks in the euro zone; a regime that combined the voluntary, contractual and statutory approaches; a statutory regime; and an informal platform for creditor debt exchanges.

70. The expert group was also working on a number of option which had not been considered by the International Monetary Fund, including the introduction of standstills in bond contracts; the idea of sovereign *cocos* (contingent convertible bonds), as put forward by the Bank of England and the Bank of Canada, which would automatically extend the maturity when a country received official sector liquidity assistance and thus acted as a standstill; and the amendment of the Fund's Articles of Agreement in order to allow for standstills.

71. Two other options being considered for improving the current architecture were the introduction of ex ante structures for creditor committees with an oversight body and a governance structure, to avoid the experience in Latin America where there had been much insider trading and misuse of information by those committees; and the adoption of the consultancy approach with soundings by legal advisors.

72. The best of the contractual approach could be combined with some kind of statutory arrangement similar to the dispute resolution mechanism of the World Trade Organization, involving three stages for orderly debt restructuring. The first stage would be purely voluntary, market-based but time-bound. If a solution was not found within that time, a second stage, again time-bound, would be for a panel of experts to guide the negotiations. If that failed, then the final stage would be for a panel of judges to pass final judgement which would be binding on all. There would be no possibility of litigation or holdout. The International Monetary Fund would play a role by hosting the dispute resolution mechanism, but the experts and others would be independent. Another option the private sector was interested in involved a neutral and informal body for creditor-debtor coordination.

73. Lastly, to alleviate the problem of the poor quality of data, a debt registry could be set up to ensure that the data used for monitoring debt sustainability was of higher quality. More work was also required to understand the relationship between regulation and sovereign debt restructuring and how the former might delay the latter.

74. **Mr. Shcherbakov** (Ecuador) said that the lack of regulation and supervision of the financial system had generated banking empires that were too big to fail and therefore had the power to make ever riskier financial transactions because they knew that States and their citizens would ultimately have to pay for defaults to prevent the collapse of their economic system. The adoption of General Assembly resolution 68/304, entitled "Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes", had marked a step forward in the effort to establish a multilateral legal framework for sovereign debt restructuring processes with a view to enhancing the efficiency, stability and predictability of the international financial system. It was unfortunate, however, that the resolution had not been adopted by consensus.

75. Nonetheless, the majority of Member States had indicated their willingness to continue working constructively to address the remaining challenges in that area, for example on global financial and monetary regulation and cooperation, including on the negotiations in the run-up to the third International Conference on Financing for Development. He hoped that the Conference would achieve an ambitious outcome, since its focus would be on assessing progress made in the implementation of the Monterrey Consensus and the Doha Declaration; identifying obstacles and constraints encountered in the achievement of the goals and objectives agreed therein, as well as actions and initiatives to overcome those constraints; and supporting the implementation of the post-2015 development agenda.

76. To that end, developing countries must be provided with assistance for long-term debt relief and sustainability through enhanced financing policies that would enable them to invest more resources in poverty eradication. The greatest challenge for humankind in the twenty-first century was to ensure the supremacy of human beings over capital. Societies should dominate, rather than being dominated by, markets. The market was a good servant but a terrible master. His Government believed in societies with a market, not market societies where people and society itself were mere commodities.

77. **Mr. Torrington** (Guyana) said that it would be interesting to know whether there was a likelihood of copycat litigation, following the Argentine case. He asked what a real fix to the problem of sovereign debt restructuring would look like. In his region, the Caribbean Community, that problem had been very significant and small, poor countries had been the target of vulture activities.

78. **Mr. de Aguiar Patriota** (Brazil) said that it was important to capture the essence of the current substantive discussion and to use it as input for future discussions on debt restructuring.

79. **Ms. Schneider** (Department of Economic and Social Affairs) said that, as a complement to the effort of the International Monetary Fund, work was being done to formulate safety clauses to address the problems of small States that issued bonds in small amounts, which made it easy for investors to build up blocking positions. With regard to copycat litigation, it was generally believed that the Argentine case was a game changer and that it would affect future debt restructuring because it had strengthened the hand of holdout creditors. However, there was also the belief that courts in the United Kingdom would to be more sanguine than those in New York when it came to interpreting the *pari passu* clause if they were faced with a case on the topic. There was even a suggestion that, for that reason, most sovereign bonds should be issued under United Kingdom law in the future.

80. As for the real fix to the problem of sovereign debt restructuring, there were several proposals on the table which should be examined more thoroughly. Nonetheless, any solution would require a buy-in by all stakeholders and future work should be aimed at seeking a consensus among them.

81. **Ms. Yuefen** Li (United Nations Conference on Trade and Development) said that, after the Argentine litigation had been taken up by the circuit court in New York, there had been copycat litigation involving the debt restructuring for Grenada, and more such cases were expected. That court's ruling had taken away the financial incentives for debt restructuring because if creditors waited long enough they could secure full payment with interest. Tools for addressing that problem included moral suasion and foreign relations. Of course, other legal forums could be resorted to, but the international community did not have a real fix for the problem. Indeed, the consensus was that future debt restructuring would be more complicated.

82. In response to the comment from the representative of Brazil, she said that all relevant debt restructuring documents and presentations from the current meeting would be made available on the UNCTAD website and, in the future, the outcomes of discussions on debt restructuring mechanisms would be shared with delegates for their consideration, but not as official documents of the General Assembly.

83. **Mr. Baqir** (International Monetary Fund), responding to the question about a real fix to the debt restructuring problem, said that the Board of the International Monetary Fund had considered the options of a treaty-based approach and a non-treaty-based approach to debt restructuring in 2003 and had opted for the latter. It had subsequently reaffirmed that position in 2013 and 2014. The problem with the treaty-based approach was that the bulk of international sovereign bonds issued by emerging markets were issued under the jurisdiction of only two countries, namely, the United Kingdom and the United States. If those countries opposed a treaty, it would not solve the collective action problem or address holdouts or vulture funds, because the signatories did not include the countries under whose laws such bonds were issued. In regard to sovereign debt restructuring, the Fund had to follow the policies approved by its Board and would continue to make lending decisions under its current policy and legal framework until it was reformed.

The meeting rose at 6.10 p.m.